

Washington State Auditor's Office
Accountability Audit Report

Washington K-12
Education System Report

Audit Period
September 1, 2001 through August 31, 2002

Report No. 6376

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Washington _____
State Auditor

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October 17, 2003

Dear Citizens of the State of Washington:

The State Auditor's Office is pleased to present this state wide summary report on the overall accountability and fiscal integrity of the Washington State Public School System.

This system consists of 296 school districts, nine educational service districts and the Office of Superintendent of Public Instruction. Our report details the overall results of our audits in these areas for the fiscal year that ended August 31, 2002.

Based on these audits, we are able to report that overall, the state public school system is a responsible steward of public resources.

We also would like to extend our appreciation to our audit clients for their constructive, positive and responsible responses.

I hope you find this summary report an interesting, enlightening and beneficial look at the state's education system.

Sincerely,

A handwritten signature in black ink, appearing to read "Brian Sonntag".

BRIAN SONNTAG, CGFM
STATE AUDITOR

Audit Summary

K-12 Education System September 1, 2001 through August 31, 2002

ABOUT THE AUDITS

This report contains the results of our independent audits of Washington State kindergarten through grade 12 public school system for the period September 1, 2001, through August 31, 2002.

We performed audit procedures to determine whether the school districts, educational service districts and the Office of Superintendent of Public Instruction (OSPI) complied with state laws and regulations and their own policies and procedures. Financial accounts and transactions were examined to determine if amounts reported in the entities financial statements are accurate and complete and to determine if districts are in compliance with applicable federal requirements. Our work focused on specific areas that have the greatest potential for abuse and misuse of public resources.

RELATED REPORTS

Separate reports are issued for individual school districts and educational school districts. OSPI is included in our Statewide Accountability Report. These reports are available on our website, www.sao.wa.gov.

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Audits of the K-12 System

**K-12 Education System
September 1, 2001 through August 31, 2002**

AUDIT AUTHORITY AND RESPONSIBILITY

The State Auditor's Office's responsibilities are set out in the State Constitution and in state law. As the public's advocate for government accountability, we perform regular financial and legal compliance audits of all state agencies and local governments including school districts. In recent years, the Legislature has given the Office new audit responsibilities related to school districts.

In response, we created a specialized schools team to work with our audit teams throughout the state when they need specialized expertise in apportionment reporting, school district accounting, special education and other areas of school district legal compliance and accountability for public resources.

Our specific responsibilities include:

- **Financial Compliance**

We regularly examine school districts' financial accounts and transactions to determine whether their financial statements are accurate and complete. The results are published in a financial statement report for each district.

- **Federal Program Compliance**

School districts spending \$300,000 or more in federal funds are required to have an annual audit of their compliance with federal program requirements. Results are published in a combined financial statement and single audit report for each district.

Recently, a four-year single audit pilot project ended that allowed us to audit federal money received by districts on a statewide level. The pilot was an alternative approach approved by the federal agencies that grant money to school districts. It allowed us to cycle many school district audits over a four-year time span. Statewide, a savings of \$2.2 million in audit costs was achieved for school districts.

Because we recognized that the end of the project would mean an increase in audit costs to some districts, we developed strategies to address this increase. They are discussed later in this report.

- **Accountability for Public Resources and Legal Compliance**

We also examine and report on districts' compliance with state laws and regulations. The results are published in an accountability report for each district.

- **K-12 Budget Drivers and State-Funded Programs**

In 1998, the Legislature directed our Office to expand reviews of data reported by school districts regarding teacher education and experience (staff mix), enrollment and bus ridership, which are factors used to determine how much state money districts will receive. The results are published in this report.

- **Educational Service District (ESD) audits**

We annually examine each ESD's financial accounts and compliance with state and federal laws and regulations and publish a financial statement and an accountability report for each ESD.

- **Office of Superintendent of Public Instruction (OSPI) audit**

OSPI is audited on an annual basis for compliance with state laws and regulations. The office is part of the State of Washington Single Audit for compliance with federal program requirements. Results of that audit and compliance with state laws and regulations may be found in the 2002 Statewide Accountability Report.

Profile of the K-12 System

K-12 Education System September 1, 2001 through August 31, 2002

BACKGROUND

The state's education system includes the State Board of Education, the Office of Superintendent of Public Instruction (OSPI), regional educational service districts and local school districts.

The State Board of Education is a policy-making body comprised of 11 members. Members are elected by school Board Members in each of the state's nine congressional districts. The powers and duties of the Board include establishing rules, standards and guidelines for schools in areas ranging from curriculum to construction. The Board's annual budget is \$400,000; it has five employees.

OSPI receives and distributes federal and state education funding, supervises school district budgeting, accounting and financial reporting, administers statewide teacher certification, and carries out educational reforms as directed by the Legislature and Congress. OSPI's budget is \$51 million and it has 370 employees. The Superintendent of Public Instruction serves four-year, elected terms.

Nine regional educational service districts provide cooperative and informational services such as accounting, financial and grants management to local school districts and assist OSPI in complying with state and federal policies. Educational Service Districts (ESD) are overseen by Boards of Directors, which are elected by the school Board Members in the District's geographical region. The ESDs have a total budget of \$184 million.

The state's 296 school districts employ about 59,000 certificated (state-funded) and about 35,000 classified (locally funded) staff who deliver educational services to approximately one million students. Locally elected school boards are responsible for districts' financial management. School boards hire a Superintendent to administer the day-to-day operations of the school district and to carry out decisions made by the Board. In fiscal year 2002, districts received a total of \$5 billion in state funding and had 94,000 employees.

K-12 SCHOOL FUNDING

The Legislature appropriates the majority of the money received by public schools. For fiscal year 2002, the system received approximately \$5 billion in state funding, representing 46 percent of the state's general fund. Of this, OSPI received and spent roughly \$36 million. ESDs received more than \$38 million.

School districts' second largest source of funds is revenue from local levies, bonds and taxes. Districts also collect Associated Student Body funds to support extra-curricular activities. Schools, OSPI and ESDs also receive funds from the federal government.

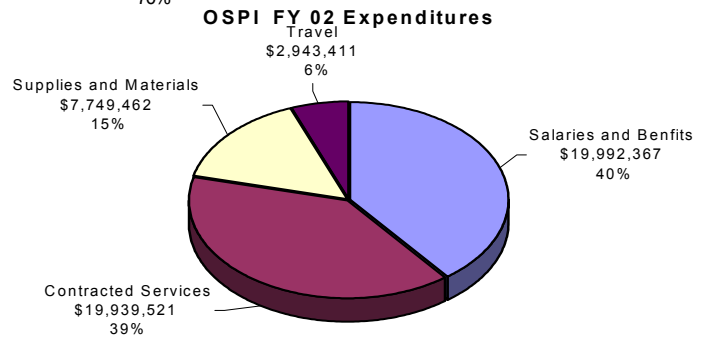
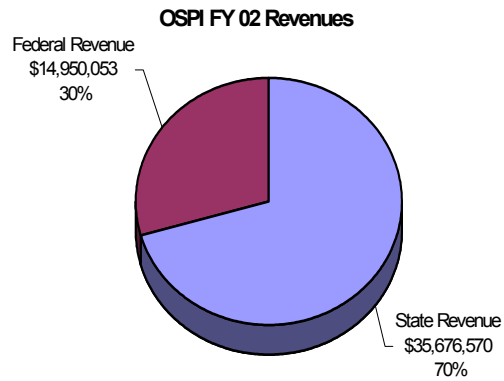
A summary of state, federal and local sources and amount of revenue and classification of expenditures for OSPI, ESDs and school districts follows. Revenue and expenditure information related to OSPI was acquired from the Agency Financial Reporting System. School district and ESD financial information was acquired from OSPI's Financial Reporting Summary for fiscal year ended August 31, 2002.

Further details on the financing of public K-12 schools may be obtained from OSPI's website, www.k12.wa.us/safs, under publications, *Organization and Financing of Washington Public Schools*.

Fiscal year 2002 School System Revenues and Expenditures for OSPI, ESDs and School Districts

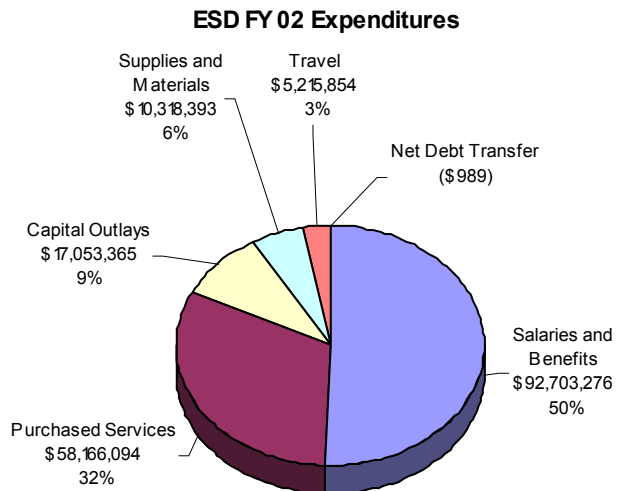
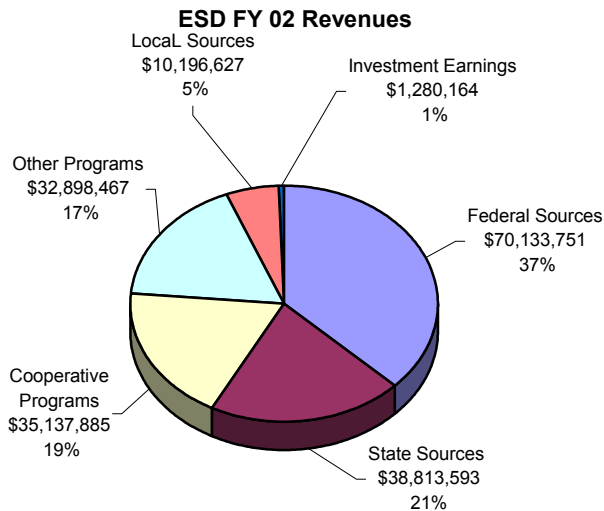
OSPI (Estimated)

<i>Revenue FY 02</i>			<i>Percent</i>	<i>Expenditures FY 02</i>			<i>Percent</i>
State Appropriation	\$35,676,570		70%	Salaries and Benefits	\$19,992,367		40%
Federal Appropriation	<u>14,950,053</u>		30%	Contracted Services	19,939,521		39%
				Supplies and Materials	7,749,462		15%
				Travel	<u>2,943,411</u>		6%
Total Revenues	\$50,626,623		100%	Total Expenditures	\$50,624,761		100%



Educational Service Districts

<i>Revenues FY 02</i>			<i>Percent</i>	<i>Expenditures FY 02</i>			<i>Percent</i>
Federal Revenue Sources	\$70,133,751		37%	Salaries and Benefits	\$92,703,276		50%
State Revenue/Appropriations	38,813,593		21%	Purchased Services	58,166,094		32%
Payments for Cooperative Programs	35,137,885		19%	Capital Outlays	17,053,365		9%
Payments for Other Programs	32,898,467		17%	Supplies and Materials	10,318,393		6%
Local Revenue Sources	10,196,627		5%	Travel	5,215,854		3%
Investment Earnings	1,280,164		1%	Net Debt Transfer	(989)		
Total Revenue	\$188,460,487		100%	Total Expenditures	\$183,455,993		100%

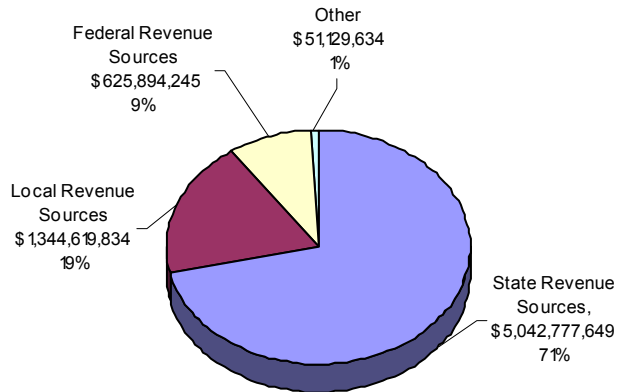


School Districts

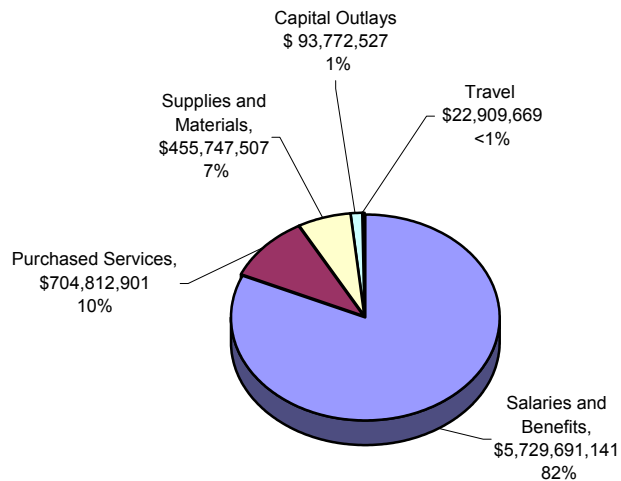
General Fund

<i>Revenues FY 02</i>			<i>Percent</i>	<i>Expenditures FY 02</i>			<i>Percent</i>
State Revenue Sources	\$5,042,777,649		71%	Salaries and Benefits	\$5,729,691,141		82%
Local Revenue Sources	1,344,619,834		19%	Purchased Services	704,812,901		10%
Federal Revenue Sources	625,894,245		9%	Supplies and Materials	455,747,507		7%
Other	<u>51,129,634</u>		1%	Capital Outlays	93,772,527		1%
				Travel	<u>22,909,669</u>		<1%
Total Revenues	\$7,064,421,392		100%	Total Expenditures	\$7,006,933,745		100%

School District General Fund Revenue



School District General Fund Expenditures



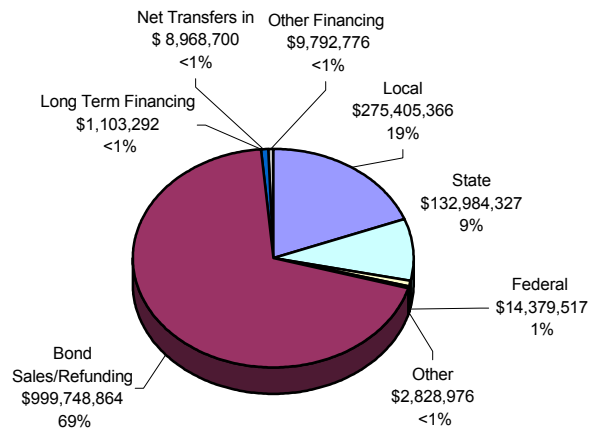
Associated Student Body (ASB) Special Revenue/Expenditures

Revenue FY 02			Expenditures FY 02		
		Percent			Percent
Student Fund-raising	<u>\$111,203,157</u>	100%	Student Activities	<u>\$110,089,629</u>	100%
Total Revenue	\$111,203,157	100%	Total Expenditures	\$110,089,629	100%

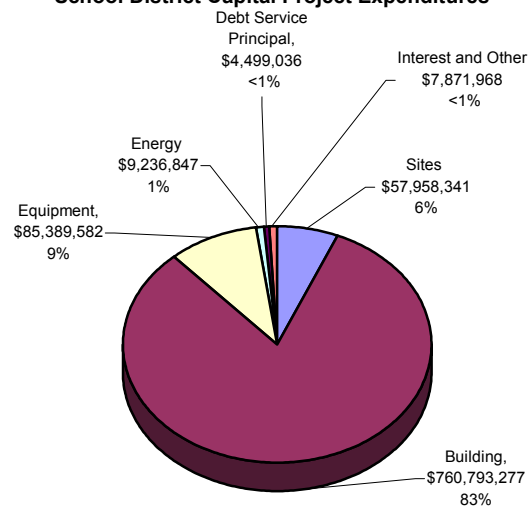
Capital Projects Fund

Revenue FY 02			Expenditures FY 02		
		Percent			Percent
Local	\$275,405,366	19%	Sites	\$57,958,341	6%
State	132,984,327	9%	Building	760,793,277	83%
Federal	14,379,517	1%	Equipment	85,389,582	9%
Other	2,828,976	<1%	Energy	9,236,847	1%
Bond	999,748,864	69%	Debt Service	4,499,036	<1%
Sales/Refunding			Principal		
Long Term	1,103,292	<1%	Interest and Other	7,871,968	<1%
Financing					
Net Transfers	8,968,700	<1%			
Other Financing	<u>9,792,776</u>	<1%			
Total Revenue	\$1,445,211,818	100%	Total Expenditures	\$925,749,051	100%

School District Capital Revenues



School District Capital Project Expenditures



Audit Areas Examined

K-12 Education System September 1, 2001 through August 31, 2002

AUDIT APPROACH

At the end of the Single Audit Pilot Project, we realized that returning to full annual audits of federal programs could have a significant effect on some districts. To mitigate that, we devised strategies that recognize districts' budget constraints and our commitment to audit more efficiently without sacrificing quality. We began using these methods in 2002 and will continue them in 2003.

- We developed an optional multi-year audit cycle approach to accountability audits of medium to small school districts. The frequency of the audit cycle is based on the size of a school district's enrollment. Audits are cycled from one to three years based on districts' audit history, significant changes and concerns expressed by constituents or others. For the very smallest of school districts, we developed a process to analyze the financial condition of the district by accessing their financial information centrally coupled with information obtained through a survey that asks district management questions about recent changes or conditions that would warrant an on-site audit.
- Audits of certain areas that determine how much money districts get from the state are planned using a statewide approach that allows us to identify areas that are most likely to result in significant errors, select specific school districts that reflect these conditions and design tailored plans for individual districts. This approach to auditing helps us to identify the most significant issues.

In keeping with general auditing practices, we do not examine every portion of an organization's financial activity during the audit. Our audits of school districts are designed using a risk-based approach focusing on those areas that represent the highest risk of noncompliance, misappropriation or misuse. Other areas are audited on a rotating basis over the course of several years.

The following are typical areas examined in the course of a district audit during this period:

ACCOUNTABILITY FOR PUBLIC RESOURCES

We evaluated accountability and overall practices for safeguarding district resources in the following areas:

- | | |
|--|--|
| • Cash receipting | • Surplused assets |
| • Payroll | • Purchase of goods and services |
| • Disbursements, petty cash, change and revolving accounts | • Associated Student Body operations and fundraising |
| • Procurement cards | • Billings and accounts receivable |
| • Inventory/property and equipment | |

LEGAL COMPLIANCE

We audit the following areas for compliance with certain applicable state and local laws and regulations:

- Student enrollment reporting
- Teacher education and experience (staff mix) reporting
- Student transportation reporting
- Budgeting requirements
- Open Public Meetings Act
- Conflict of interest laws
- Public records retention
- Competitive bidding requirements
- Transfers between funds
- Deposit and investment of public funds
- Use of restricted funds
- Financial statement preparation and journal entries
- Debt limitation
- Public works contracts, change orders and prevailing wages

FEDERAL PROGRAMS

For each school district spending \$300,000 or more in federal funds we evaluated internal controls and examined compliance with federal requirements for the major federal programs that are listed in the Federal Summary section of each district's financial statement and single audit report. The largest and most common programs selected for audit in this cycle were Title I (funding to enhance teaching and learning in districts with high concentrations of children from low-income families), Special Education and the National School Lunch program.

FINANCIAL

Financial statement opinions for those districts receiving a financial statement audit for fiscal year 2002 are included in a separate report on the district. Their report includes the district's financial statements and other required financial information. The financial activity and balances we typically examine include:

- Cash and investments
- Revenues
- Property taxes
- Expenditures
- Payroll
- Receivables
- Financial statement preparation, journal entries and transfers
- Cut-off and subsequent events
- Long-term debt
- Other liabilities
- Fixed assets
- Deferred revenues
- Financial condition and going concerns
- Related party transactions
- Overall presentation of the financial statements

Audit Results

K-12 Education System September 1, 2001 through August 31, 2002

During the 2002 fiscal year, we conducted audits of legal compliance and accountability over public resources at 152 school districts. Following are the results of those audits.

Issues we find during our audits are reported at two levels, depending on their significance and the steps taken by management to address them.

- Findings address serious issues of noncompliance with legal requirements or pervasive and continuing internal control weaknesses and are published as part of our audit report.
- Management letter items are significant, but do not rise to the level of a finding, often due to corrective action already instituted by management.

ACCOUNTABILITY FOR PUBLIC RESOURCES

Cash Receipting

We audit cash receipted through Associated Student Body activities, payments for student breakfast and lunch, and other fines and fees.

Findings: Nine

Issues: Inadequate policies and procedures to ensure appropriate handling and accounting for cash receipts. One finding is related to a fraud surrounding a loss of \$143,000. This was due to severe internal control weaknesses in the district's cash receipting and lack of accountability over cash handling.

Other conditions of note: Similar but less severe conditions were found at 17 districts. These were primarily minor weaknesses in processing cash receipts and timeliness of bank reconciliations.

Disbursements

School districts disburse funds via warrants, electronic fund transfers, checking accounts and petty cash.

Findings: One

Issues: Inadequate controls over the issuance and monitoring of usage of procurement cards. Disbursements were not supported by original receipts and did not include documentation demonstrating a valid business purpose.

Other conditions of note: Four other school districts were found to have less significant conditions related to staff not properly accounting for all expenditures in the records and district staff not following school district travel policies.

Inventory/Property and Equipment

We examine school district policies and procedures to determine whether districts' methods to track assets are adequate to prevent or detect misappropriation in a timely manner and that inventories are conducted periodically.

Findings: One

Issues: The district did not maintain adequate control over computer assets. We found a listing of the district's computer assets was outdated and equipment was not consistently identified as belonging to the district. The district's own physical count of equipment revealed many items that could not be located. The approximate value of missing items is \$360,000.

Other conditions of note: In 10 of the districts we audited, we noticed the districts lack adequate controls over inventory. Items were not tracked as purchased and periodic physical inventories were not taken. In one district, their monitoring of parts inventory for buses detected missing items.

Payroll

Our audits of school district payroll include an examination of districts' controls over access to payroll data, adequate separation of key duties and whether districts have appropriate checks and balances in place to detect an irregularity in a timely manner.

Findings: Two

Issues: Access to approved timesheets was not adequately controlled, increasing the risk of loss or abuse. Effective controls were not in place to ensure employees do not duplicate requests for extra time and monitoring of payroll activity at school buildings was inadequate to detect loss or misappropriation in a timely manner. In one of the districts, we found the payroll processing system was weak and had allowed a \$6,000 overpayment to be processed. The overpayment was subsequently reimbursed.

Other conditions of note: In two school districts, we found inadequate monitoring of work activities that supported a staff member's salary and weaknesses in a new computerized payroll system that put the district at risk of misappropriation or abuse of public funds.

LEGAL COMPLIANCE

Apportionment

Schools receive state funding based on their enrollment, bus ridership and education and experience of certificated instructional staff (staff mix). Because nearly 75 percent of state funding received by schools is through apportionment, it is very important that school districts accurately report this information so that the proper level of funding is received.

At the direction of the Legislature, the Washington State Auditor's Office verifies the accuracy of school district apportionment reporting by performing regular audits of enrollment, staff mix and transportation.

Over the past four years, our Office has seen improved results in the information schools submit to the state to receive apportionment funding. We have noticed a decline in exceptions we would

consider as reportable conditions. Total results of conditions reported as a finding or a management letter over this time period are:

	School District Fiscal Years			
	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Enrollment	14	30	23	25
Staff Mix	3	8	16	15
Transportation	7	12	25	29

Our Office recommended recovery of state funds from corrections to the exceptions stated above.

For the state 1999-2001 biennium, we recommended \$2,367,293 in recovery and as of publication of this report, for the 2001-03 biennium, we have recommended \$1,670,502 in reimbursements to the state. Recovery related to work currently being concluded has not yet been determined. OSPI is responsible for determination of final recovery amounts.

Here are the detailed results of our audits in the areas of enrollment, staff mix and transportation reporting for fiscal year 2002.

Enrollment

Enrollment in Washington schools is reported in several categories. These are basic education, bilingual, Running Start (high school students enrolled in college courses), special education and vocational instruction. Basic education and vocational education may encompass programs such as Alternative Learning Experience and work-based learning. Our most recent audits were targeted primarily at districts' September reporting of basic education, work-based learning as a component of vocational education and special education. These areas were identified through analysis and audit history as having a higher likelihood of reporting errors.

Basic Education

School districts received, on average, \$3,866 per student enrolled full time in basic education. In the 2002 school year, the state funded approximately 948,000 basic education students. We selected seven school districts for audit, based on enrollment trends that identified significant enrollment fluctuations for the month of September.

The districts selected represented \$206 million of state basic education expenditures.

School districts are required to report basic education student enrollment for September through May. Funding is then calculated on the average enrollment over the nine-month period.

Findings: Two

Issues: We found district officials did not understand that September enrollment was to be used in the calculation for funding basic education. September and October were audited to determine whether students who were withdrawn by October should have been counted in September. In three of the districts we audited, we found that 167 students of a combined reported enrollment of approximately 6,710 had been incorrectly counted in the month of September. The majority of these students had been carried over from one grade to the next at year-end, but had not returned to the districts in September. These errors were significant enough in two districts to result in findings.

Other conditions of note: Records in four districts were generally lacking sufficient detail to support accurate enrollment counts. We found other minor instances of inaccurate September enrollment counts.

Vocational Education

Districts receive approximately \$700 per student in enhanced funding for students enrolled in vocational programs. This is in addition to funding they receive for counting the same students for basic education for the time they spend in vocational classes. In the 2002 school year, the state funded approximately 55,800 vocational students.

Work Based Learning was audited as a component of vocational education. This program allows students to obtain credit and districts to claim funding for students employed in a work/learning environment. Student counts for this program are subject to limits in the number of hours they may work. We audited 24 school districts for compliance with regulations over this program. Eighteen of these districts were found to be incorrectly reporting students' full-time equivalency and three were not retaining sufficient records to support the hours claimed.

Findings: One

Issues: The district receiving the finding did not retain certain records for work-based learning students. In addition, the district's method of calculation of the number of students enrolled in its vocational program and actual hours of work experience led to over-reporting.

Other conditions of note: In two other districts audited, we found similar but less severe conditions of insufficient documentation to support student work experience hours.

Special Education

School districts provided special education services to approximately 120,000 special education students, ages three to 21 in fiscal year 2002. State funding for these students was approximately \$419 million. Special education funding for school districts is based on a monthly headcount of eligible students. A special education student is eligible for funding when he or she has a current Individualized Education Plan (IEP), a current evaluation and is receiving specially designed instruction. Annual IEPs are required. Evaluations must be completed every three years.

We selected 32 school districts for this audit. The districts selected represented 38 percent of the state's total special education population and \$160 million of state special education expenditures.

Districts were selected for audit based on one of the following criteria:

- The number of special education students was over 12.7 percent of the district's basic education population during 2000-01 and/or 2001-02.
- The district applied for additional funds for its special education program during 2001-02.
- Audit history revealed findings or management letters that reported significant errors.
- Significant size (special education population of 3,000 students) not previously audited by special education audit specialists.

Two compliance areas were examined during our audit of these 32 special education programs. These were:

- Were IEPs completed annually? Did they address the needs identified on individual student evaluations? Were evaluations completed every three years?
- Did the student's evaluation clearly state the student needed special education services and indicate students were receiving specially designed instruction?

For each district audited, a five percent sample of the special education population was selected for review. The results of this work are as follows:

- 99 percent of IEPs and evaluations reviewed were properly prepared and completed on time and 80 percent of the special education students were provided the services as recommended on their evaluations.
- 97 percent of special education students were receiving specially designed instruction and 99 percent of students receiving special education services were properly identified as eligible for those services.

Findings: Two

Issues: In one of the two districts for which findings were issued, 15 percent of the students we audited did not have up to date IEPs, evaluations, or were not receiving specially designed instruction. We found a similar condition along with a lack of documentation supporting the claim for state funds in the other district.

Other conditions of note: In three districts audited, we noted a few instances of students who did not have a current IEP or evaluation who were claimed special education funding.

Through the course of our audit, we observed districts that appropriately removed students from enrollment reports due to untimely IEPs or evaluations and consequently did not receive funding for these students. This resulted in a loss of revenue for those students who were still being provided special education instruction by the school district but were ineligible for funding. In the 32 districts audited this year, approximately \$1.5 million in state and federal revenue was lost due to IEPs or evaluations not being completed on time. The 12.7 percent state funding lid was factored into the determination of the lost revenue.

Staff Mix

The number of instructors funded in each of the state's school districts is driven by a formula that takes into account standardized staffing ratios based on district enrollment.

State funding for staff mix is blended in funding for basic enrollment. Together this amounted to approximately \$4 billion annually.

Our analysis of statewide reports on school district data supporting staff funding led us to target certificated instructors with masters' degrees. At the time an instructor earns a master's degree, their total credits earned are reduced by 45. The reduction of credits appeared to be lacking in the data we analyzed.

As a result of the analysis, we targeted 595 certified instructional staff at 57 school districts to determine the accuracy of the years of relevant work experience, degree level and credits earned. These districts received approximately \$1.8 billion in funding.

Findings: One

Issues: Our audits disclosed an aggregate of 67 certified instructor files with errors that affected state funding. Errors discovered that did not affect state funding total 240.

As a result of significant inaccuracies in reporting the highest degree earned, educational credits and experience, our Office issued a finding for one district in the area of staff mix reporting.

Other conditions of note: Minor instances of misreported staff information occurred in two school districts.

Transportation

School districts receive state funding to provide transportation services to students. In the 2002 fiscal year, this funding totaled about \$196.7 million to transport approximately 480,000 students.

Transportation operations funding is based primarily on a formula that takes into consideration the number of students that are receiving transportation services within the district and the distance that these students are transported. This is referred to as the ridership formula and was used to allocate approximately \$176.9 million in 2002.

School districts also are reimbursed when they purchase new buses. This allocation is based on the type of equipment that the district operates as well as the reimbursement schedule. Payments to school districts for reimbursement of transportation equipment totaled approximately \$19.8 million in 2002.

In order to receive state funding for transportation, school districts are required by state law to submit a report every October that provides ridership data to OSPI. The State Auditor's Office reviews school district transportation reporting to ensure that funding is being allocated properly.

As a part of our audits, we performed a statewide analysis of transportation reporting for all school districts in the state. This analysis compared changes in reported ridership for the past three years to changes in school district enrollment over the same time period. We focused our attention on areas of transportation reporting such as route type classifications, which pose the greatest challenge to school districts across the state. As a result of this analysis, we selected districts to audit based on large numbers of shuttle routes and route types with higher funding.

In the course of conducting our analysis, we found missing or incomplete data in 27 districts' transportation reports.

Fifty-three school districts were selected for audit in the 2002 reporting period. The districts selected represented \$56 million of student transportation funding or 31 percent of the state's total student transportation expenditures.

Findings: Four

Issues: The primary cause of the errors was the lack of appropriate monitoring to ensure the data submitted was accurate.

Other conditions of note: We found minor reporting exceptions in three other districts. These exceptions were not significant enough to warrant findings.

Of the 2,121 bus routes that were examined, 55 route classification errors were identified. We also found that school districts had over reported 224 riders and under reported 108 riders on different routes. Lastly, our audit determined that 23 routes were reported with incorrect map coordinates that effected transportation funding.

Most of these errors were attributable to school district staff incorrectly reporting route types or miscalculating map coordinates or ridership counts.

OTHER LEGAL COMPLIANCE AREAS

Public Records Retention

State law requires protection of essential records. State Archives and the Records Management Division in the Secretary of State's Office have developed records retention and disposition schedules identifying the required length of time to preserve original documents.

Findings: None

Issues: We found no issues significant enough to report as findings.

Other conditions of note: The absence of available records is a common underlying cause in many of the areas in which we find audit issues. Exceptions were found in two districts audited. We found redeemed warrants were not retained in one district. The state requires these records be preserved for six years. In the other district, we found student records supporting actual work experience had been shredded and the district lacked supporting documentation for allocation of costs charged to a capital project.

Competitive Bidding

School districts are required by state law to solicit formal bids on certain purchases of \$50,000 or more. Competitive bids are required on certain purchases of \$15,000 or more.

Findings: None

Issues: We found no issues significant enough to report as findings.

Other conditions of note: Of the districts we examined for compliance with laws governing the bid process, we identified two instances in which districts did not have sufficient documentation to support compliance with formal and competitive bid requirements.

Open Public Meetings

School districts are required to comply with the Open Public Meetings Act. The law allows districts to hold executive sessions in certain circumstances and following certain procedures.

Findings: None

Issues: We found no issues significant enough to report as findings.

Other conditions of note: We found one instance in which an executive session was held for a purpose not authorized by state law.

Expenditures Exceeded Budgeted Appropriations

State law requires school districts to limit expenditures to budgeted appropriations. When a district finds its budget is not sufficient to pay approved expenditures, the school Board must authorize the additional expenditures.

Findings: Two

Issues: In each of the districts issued findings, the district's budget monitoring process was not sufficient to alert the district to the need to amend the budget before year end.

Other conditions of note: In several districts, we noted a budget amendment occurred after the funds were spent.

Federal Programs

Federal regulations require public entities to receive annual audits of federal financial assistance when they have federal expenditures and/or loans of \$300,000 or more. As mentioned earlier, the Washington Education System Single Audit Pilot Project concluded in September 2002. For the four years prior to fiscal year 2002, this project combined all entities providing K-12 education services into one entity known as the Washington Education System. We audited the federal compliance for the system as a whole and one audit report was issued for the entire system. Beginning with fiscal year 2002 audits, the Office resumed auditing school districts individually for federal compliance.

However, in 2003, the Office successfully pushed a change in federal regulation that could mean a cost-savings for districts and other local governments. Effective for fiscal years ending after December 31, 2003, public entities spending \$500,000 or less in federal money will not need a single audit under the requirements of Federal Office of Management and Budget (OMB) Circular A-133.

However, due to significant changes in federal programs brought on by the federal No Child Left Behind Reauthorization Act, we anticipate few school districts will benefit from the increased threshold for audits of federal programs. An overall increase in federal funding is expected as a result of these changes.

For fiscal year 2002, school districts received over \$625 million in federal assistance. This represents 8.83 percent of total revenues received by school districts for the year.

The largest single grantor was the U.S. Department of Education, which provides funding for programs such as Title I and Special Education. We focused our federal audit work in these areas for fiscal year 2002.

We audited federal financial assistance of 208 school districts. We reviewed internal controls and compliance with grant requirements. Federal audit regulations require that we formally report deficiencies in the design or operation of internal controls an organization institutes to ensure compliance is achieved. Additionally, we are required to formally report known or likely questioned costs over \$10,000 for each compliance area of a grant. Questioned costs are often reported for the following reasons:

- Violations of a law, regulation or grant agreement that governs the use of the federal funds.
- Costs that are not adequately supported by documentation.
- Costs that appear unreasonable.

Findings: Eighty-Three

Issues: We reported findings for 64 out of the 208 school districts. We reported 83 federal findings. Two major issues were noted:

- Nearly 60 percent of the findings issued were due to lack of time and effort records, such as time sheets, to support payroll charges to federal programs.
- Nine findings were issued for noncompliance with various Title I requirements, many of which resulted from missing or incomplete documentation.

Other conditions of note: Forty-seven less significant exceptions to compliance with federal regulations were reported. These were in such areas as program monitoring and allowability of questioned costs less than \$10,000.

Title 1 provides funding to enhance teaching and learning in districts with high concentrations of children from low-income families. We expect that the trend of issues with the Title I program will continue as districts strive to comply with federal regulations related to the No Child Left Behind Act.

Financial

The State Auditor's Office is required by state law (RCW 43.09.260) to review the financial affairs of all local government entities including school districts. Our audits are intended to provide assurance that school districts accurately report their financial positions and operating results to citizens and the Legislature.

The very smallest school districts, those that have no high school or fewer than 100 students, complete a questionnaire about financial activity during the past year and have their financial information reviewed annually. In 2003, approximately 40 districts' information was reviewed in this way. If the results of this review indicate significant financial risk, then an audit of the financial statements is performed. Significant financial risk would include major declines in financial condition or financial statements that appear to be significantly incorrect.

For the first time in several years we have findings disclosing conditions we consider to be significant to the financial representations of three school districts.

Findings: Four

Issues: In 2003 we audited 228 school districts' financial statements. We reported four findings for three districts regarding their financial statements and internal controls over financial reporting. These three districts had critical budgetary and financial issues. Inconsistent accounting practices and failure to monitor financial operations prevailed in each of the districts.

Other conditions of note: Audits of four districts revealed other minor financial reporting conditions that did not rise to the level of a finding. These were due to expenditures recorded in the wrong fiscal year and fund balances which had significantly declined and were not sufficient to cover expenditures.

We have seen a growing trend of fund balance declines in school districts. Though a statewide average of fund balance remaining at 2002 year end reflects a slight increase over 2001; our audits have revealed some school districts are facing a potentially serious erosion in their financial condition by having fewer resources available for emergency or contingency purposes. This is a result of various factors including a decline in state revenues, levy failures, local spending philosophies, and varying skills and experience in monitoring and managing budgets.

During our 2002 audits, we noticed that some districts were overestimating the amount of federal revenue they were to receive. That information is used, in part, to determine districts' levy base. School districts' levy authority also was reviewed by the Joint Task Force on Local Effort Assistance, which submitted a report to the Legislature in 2002. That report also indicated that some schools inflated estimated federal revenues in order to increase the levy amount.

It also recommended that the issue be resolved through the rule-making process at OSPI.

During our audits, we analyzed the effect of this by comparing 2002 estimated federal revenues to the actual federal revenues of 31 school districts. Our analysis disclosed \$43 million more was estimated than what was actually received.

OSPI recently proposed rule changes that would remove estimated federal revenues from the calculation. These changes have passed the hearing process and should take effect September 2004 and apply to levies beginning in 2005.

Conclusions and Recommendations

K-12 Education System September 1, 2001 through August 31, 2002

CONCLUSIONS

The good news is, in most areas examined, school districts complied with state laws and regulations, their own policies and procedures, and have sound internal controls. However, as previously stated, we did find conditions significant enough to report as findings and other exceptions.

Where we identified no significant issues, we found districts had strong policies, well-trained, experienced and knowledgeable staff and an effective monitoring system in place to identify and correct problems in a timely manner.

Most of the findings issued on federal programs dealt with very complex requirements. We found in many instances school staff delivering the services were not fully aware of strict federal requirements. Auditors are required by federal agencies to follow reporting guidelines when weaknesses in design or operation of internal controls are found and to report as findings all instances of noncompliance with federal regulations and known or likely questioned costs of more than \$10,000.

RECOMMENDATIONS

During the current audit of school districts, we have observed common conditions prevailing through many of the exceptions we identified. In light of certain complex state and federal laws and district staff turnover, there is a significant need for training and district monitoring.

Various education and state organizations offer workshops in federal grants management, compliance with state laws and accountability over public resources, developing and implementing sound internal controls, as well as courses in budgeting and sound financial management practices. We encourage school districts to take advantage of these opportunities.

Local school district policies and procedures are important tools and resources for employees and others conducting business with schools. We recommend districts examine their policies to determine if they are adequate and review their internal controls to ensure misappropriation or abuse of public funds and frauds would be detected in a timely manner to minimize loss to the district. We also recommend districts continue to reassess their financial management and budget monitoring practices including policies related to contingency targets (fund balance) and expectations for reporting the district's financial condition monthly to the Board.

Audit Focus for Fiscal Year 2003

K-12 Education System September 1, 2001 through August 31, 2002

Based on work we did in 2002, issues raised by lawmakers, citizens and others and our own evaluation of risk, we have set an audit focus for the next round of school district audits.

Accountability For Public Resources

Within the school district environment, certain areas are almost always considered high risk. Associated Student Body fund-raising activities, cash handling and safeguarding of public assets will be examined to determine if school districts have adequate monitoring practices in place.

Legal Compliance

Alternative Learning Programs are components of basic education and funded at the same rate per student as basic education. Requirements for counting students in these programs are different than for regular basic education and we have noted that districts struggle with compliance. In the current year, we surveyed all districts in the state to determine which ones offer these programs and the number of students enrolled. The survey responses will be analyzed and districts selected for audit in the next year to assess compliance with student count requirements on a statewide basis.

During the next cycle of school district audits, we will continue to look at areas that reflect a higher risk of misuse in light of the financial climate. These areas include funds legally restricted for specific purposes, management of state grants and compliance with competitive bid laws.

Federal

Fiscal year 2003 was the first year that the changes under the federal No Child Left Behind Act became effective. The requirements of the Act are significantly different from previous program requirements. The federal portion of our audits will be focused on compliance with the new regulations, such as transferability of grant funds to other programs and earmarking requirements.

Financial

In light of the financial struggles we observed in some school districts during the 2002 audits, we will continue to focus on the financial health of K-12 public schools. Our audits will include an examination of school districts' processes for monitoring their financial operations. This will include adherence to approved budgets, consistency with accounting practices and timely reporting and accuracy of financial condition to school Boards.

Resources

TRAINING AND OUTREACH

One of the ways we fulfill our mission of promoting accountability, fiscal integrity and openness in government is through training and outreach.

Our staff provides hundreds of hours of training each year to school districts, school associations and to our auditors. We develop training and present workshops on proper methods and accuracy of reporting data for state funding. These workshops cover reporting for student bus ridership, enrollment and information on district's certified instructional staff.

This past year we have presented workshops in conjunction with the Washington Association of Business Officials on Associated Student Body public funds and activities. Federal grants management workshops and workshops on new rules affecting financial reporting were jointly developed and presented by our Office and the Office of Superintendent of Public Instruction.

As part of our proactive approach to promoting accountability, we are available to answer questions and provide professional assistance in understanding state and federal laws and rules and regulations that govern school districts.

These activities emphasize our desire to work with school districts to share common issues that we found during our audit work.

SPECIALISTS

We provide school audit specialists who examine statewide audit results and develop workshops to help districts address common issues we find regarding compliance with state and federal rules and regulations.

INNOVATION

As an advocate of accountability over public resources, the State Auditor's Office is committed to finding ways to improve the way we do business. In the past year, we developed a new tool to help with audit planning. Working with the Washington School Information Processing Cooperative, we developed a process that allows districts to electronically send transactional-level detail to us. The Financial Analysis Program uses this data to produce computer assisted audit tests that allow our auditors to plan audits more efficiently, minimizing travel costs and reducing the amount of time school district staff must spend to gather information for audit purposes.